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SUBJECT: Argentina Economic and Financial Weekly for
the week ending June 9, 2006

Weekly Highlights

- Bolivian and Argentine presidents to meet next week on price of Bolivian gas exports.
- Argentina and Mexico sign trade agreement.
- IMF mission in Argentina for Article IV review.
- GOA renegotiation of Paris Club debt to take place after September.
- CPI rose 0.5 percent m-o-m in May -- below market expectations. PPI rose 0.3 percent m-o-m.
- Commentary of the Week: "Lavagna, Moreno, and the Felisa Code"

Bolivian and Argentine presidents to meet next week on price of Bolivian gas exports.

¶1. The presidents of Bolivia and Argentina are scheduled to meet next week to reach an agreement on the price of Bolivian gas exports to Argentina. No specific date was announced, however. There have been technical level negotiations between the two governments, but difficulties in reaching an agreement have delayed the meeting between the two presidents. Earlier this week, local media reported that the GOA presented a counteroffer to the GOB to buy Bolivian gas at a price of USD 5 per million cubic meters against the Bolivian offer of USD 5.50 per million cubic meters. [Argentina currently imports 5 percent of its gas consumption from Bolivia at a "solidarity" price of USD 3.20 per million cubic meters, while the international price ranges between USD 2.00 and USD 8.00 per million cubic meters.] Meanwhile, on June 8, the GOB warned that it will not be able to fulfill external demand for gas if it does not start exploring for new reserves.

Argentina and Mexico sign trade agreement.

¶2. On June 8, Argentina and Mexico signed an investment agreement to strengthen bilateral trade. The agreement seeks to double trade between the two countries in the next four years by increasing the number of goods given preferential tariffs, as well as by paving the way for Mexico to join Mercosur. Bilateral trade between Mexico and Argentina increased 17 percent y-o-y to USD 1.9 billion in 2005. Argentina's exports to Mexico reached USD 1.1 billion in 2005, while Mexico's exports to Argentina make up the remaining USD 800 million.

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Minister of Economy denies radical labor reforms.

¶3. On June 7, Minister of Economy Felisa Miceli denied that labor reforms that would negatively affect businesses will be passed, as some businessmen fear. She clarified that only partial amendments to the Labor Reforms of the 1990's will be implemented. In her statements to the press, Miceli also recognized that GOA expenditures will grow only as long as fiscal revenues grow, in an attempt to eliminate concerns over the reduction of the GOA primary fiscal surplus in recent months.

IMF mission in Argentina for Article IV review.

¶4. According to local media, the IMF delegation visiting Argentina for the Article IV review raised three major concerns on the Argentine economic performance: inflation and the GOA strategy to deal with it (through price restraint agreements); the investment climate; and renegotiation of privatized utility contracts. The IMF mission praised GDP growth and the fall in the unemployment rate. Meanwhile, Minister of Economy Felisa Miceli and BCRA President Martin Redrado called for "intellectual honesty" by the IMF in recognizing its own mistakes in contributing to Argentina's financial collapse in 2001-2002 and later failing to correctly diagnose the recovery of the economy.

GOA renegotiation of Paris Club debt to take place after September.

¶5. On June 7, Secretary of Finance Alfredo Mac Laughlin announced that Argentina will delay its Paris Club debt renegotiations until September -- after the Soccer World Cup and the northern hemisphere's summer holidays. He said that the GOA envisions a renegotiation in which the GOA recognizes the principal and interest arrears (unlike the GOA debt restructuring with private creditors who suffered a seventy percent net present value reduction). According to the GOA, Argentina's Paris Club debt totals USD 6 billion, of which 60% is owned to four countries: Japan, Germany, Spain and the Netherlands. The Secretary also said that the GOA will discuss its renegotiation proposal bilaterally with major creditors, and then seek to reach a global agreement with the Paris Club as a whole.

¶6. However, in a conversation with the DCM on June 9, MacLaughlin said that he was planning to meet with six key creditor governments this month. He also clarified that there was nothing being discussed with the German government that is different from what Argentina will discuss with the other key Paris Club creditors.

GOA financial needs complete for 2006.

¶17. In a press conference on June 7, Secretary of Finance Alfredo Mac Laughlin announced that the GOA had met its 2006 financial needs with funds from the primary fiscal surplus and bond issues during the first half of the year. He recognized that if the GOA were to issue the remaining USD 500 million Bonar (which the GOA is authorized to issue), it would have to accept a yield of more than 9.00 percent -- compared to the 8.09 percent achieved in the last GOA auction -- due to the recent market instability affecting all emerging markets. However, he did not discard the possibility of issuing more Boden 2012 bonds to Venezuela.

The World Bank grants USD 3.3 billion loan to the GOA.

¶18. On June 6, the World Bank (WB) approved a USD 3.3 billion program to finance investments in Argentina for the next three years. This program which is part of the Country Assistance Strategy, which includes more than 30 loans for infrastructure, health, environmental and education projects. WB authorities stated that loans will only be approved for investment purposes. The first two loans -- already approved -- will finance improvement of the water supply and prevention of floods. The WB directors praised Argentina's economic recovery, but also asked for a better investment environment, a consolidation of the fiscal equilibrium, the renegotiation of private utility tariffs and a solution to the USD 20 billion in debt holdouts (bondholders who didn't participate in Argentina's debt restructuring).

Martin Redrado defends the BCRA's monetary policy.

¶19. On June 5, Central Bank (BCRA) President Martin Redrado defended the BCRA's monetary policy and assessed it as a success in handling the volatility that has affected all international financial markets since mid-May. Redrado explained that the "prudent and predictable" BCRA monetary policy of accumulating reserves, as well as bank risk management to consolidate a strong domestic financial system, reduced the negative impact of sudden changes in international markets. According to Redrado, the BCRA's reserve accumulation strategy is not adding to inflation because the BCRA's peso emissions are being sterilized.

GOA denies rumors about a ban on corn exports.

¶10. On June 6, Secretary of Agriculture Miguel Campos denied that the GOA would implement a ban on corn exports. This statement came in response to rumors about limits on corn exports to increase the local corn supply in an attempt to maintain domestic prices low, and after the GOA tried to lower flour and bread prices by "voluntarily" forcing exporters to limit wheat exports. Corn and wheat exports are subject to 20 percent export taxes. Argentina is the world's second largest corn-exporter and the fifth largest wheat-exporter.

GOA seeks to create a special prosecutor's office to fight against trademark violations.

¶11. The Attorney General's office has proposed a bill to create a special prosecutor's office to fight against trademark forgery and counterfeiting. The bill seeks to increase fines to discourage forgery, which is estimated to generate loss of USD 500 million to the owners of trademarks. Also, Congress is considering a bill to give AFIP -- the tax authority -- an active role in the criminal process against trademark violators.

Tax revenues increase 19 percent y-o-y to ARP 14.3 billion in May, and reach a record high.

¶12. May federal tax revenues increased 19 percent y-o-y to ARP 14.3 billion -- slightly below market expectations of ARP 14.5 billion -- but still set a new record high. Labor contributions rose 48 percent y-o-y due to increases in formal job creation and salary increases, while VAT revenues increased 19 percent y-o-y mainly due to the increase in economic activity. Income tax and export tax revenues increased 14 percent y-o-y and 10 percent y-o-y, respectively. In real terms, revenues increased 8 percent y-o-y. May tax revenues reached ARP 56.4 billion in the first five months of the year (a 21 percent y-o-y increase), reaching 39 percent of the BCRA consensus survey forecast of ARP 143.1 billion for 2006.

CPI rises 0.5 percent m-o-m in May -- below market expectations. PPI rises 0.3 percent m-o-m.

¶13. The Consumer Price Index (CPI) increased 0.5 percent m-o-m in May, below market expectations of 0.7

percent, and following a 1.0 percent m-o-m increase in April. The better-than-expected result is due mainly to decreases in food prices, which represent almost one-third of the Index. Last month's increase brought inflation to 4.4 percent in the first five months of the year, compared to a 5.2 percent increase in the same period last year. CPI core inflation was up 0.7 percent, while the seasonal component of the index decreased 0.6 percent and the regulated component increased 0.2 percent. The categories with the highest price increases were housing (+2.2 percent), clothing (+2.1 percent) and education (+1.3 percent). Meat prices (representing 4.5 percent of the consumer basket) decreased 2.4 percent m-o-m due to price restraint agreements between the GOA and the meat sector and the partial ban on beef exports. Year-on-year, the CPI rose 11.5 percent. The BCRA consensus survey forecasts 12.0 percent inflation in 2006, unchanged from last month's forecast. The 2006 budget projects a 9.1 percent inflation rate for 2006 and the Central Bank's inflation target range is 8-11 percent. The basic food basket -- used to measure poverty and indigence -- decreased 1.5 percent mom in May, the largest decrease since May 2003.

¶14. Producer prices increased 0.3 percent m-o-m in May, due to a 1.6 percent decrease in primary goods prices and a 0.9 percent rise in manufactured goods prices. The price of electricity remained unchanged, while the price of imported goods increased 1.7 percent. The PPI index increased 11.4 percent y-o-y.

¶15. In a press release from June 2, Indec -- the National Bureau of Statistics responsible for calculating the CPI -- defended itself from criticisms from consumer defense associations complaining that

the CPI does not reflect the inflation suffered by the population, saying that the CPI's calculation follows specific norms and internationally regulated standards.

May labor demand index down 5.56 percent m-o-m.

¶16. The May labor demand index calculated by Di Tella University decreased 5.56 percent m-o-m to 105.35 points, the index's fifth fall in six months after a 1.0 percent increase in April. Labor demand has decreased 7.65 percent so far during 2006. The decrease is mainly due to a fall in the demand for professionals (-15.39 percent) followed by technical employees (-14.98 percent) and commercial personnel (-4.69 percent). The index is up 3.1 percent y-o-y. [The index is based on comparisons of job vacancy announcements printed in the two largest newspapers of the country.]

¶17. Separately, Indec announced the results of its unsatisfied labor demand index which attempts to measure the difficulties that companies have finding skilled employees. According to the survey, 40 percent of companies looked for employees in the first quarter of 2006, out of which 12 percent could not fill their open positions. The unmet demand is composed of 39 percent technical employees, 33 percent professionals and 28 percent operational employees.

April wage index increased 1.62 percent m-o-m

¶18. The GOA announced that the wage index increased 1.62 percent m-o-m in April. This index defines wages as a price, without considering hours effectively worked or special payments for productivity gains. This index surveys the formal and informal private sector and the public sector, which increased 1.99 percent, 2.31 percent and 0.16 percent, respectively.

BCRA rolls over its maturities and shifts its issuance policy to short-term Lebacs.

¶19. The BCRA received ARP 1.6 billion in bids at its June 6 Lebac and Nobac auction, compared to the ARP 841 million in Lebacs that came due during the week. It accepted Lebac bids totaling ARP 1.2 billion, representing 98 percent of the total, with Nobac bids accepted for the remaining 2 percent. The yield on the 91-day Lebac was 7.25 percent, while the yield on the 168-day Lebac remained at 8.36 percent and the yield on the 259-day Lebac decreased 16 basis points from 10.38 percent to 10.22 percent. The yield on the longest term Lebac, the 357-day Lebac, remained 11.90 percent. Lebacs with maturities of more than 357 days were withdrawn due to lack of interest. The spread on the one-year Nobac decreased from 2.28 percent to 2.13 percent and from 3.35 percent to 3.10 percent for the two-year Nobac. The Badlar rate (the base rate for Nobacs) is currently at 9.1 percent.

¶20. During May, the BCRA changed its monetary policy, shifting from long-term instruments with variable rates (Nobacs composed 33 percent of the month's total issuance) to shorter-term instruments with a fixed rate (Lebacs made up the remaining 67 percent of May's total issuance). The share of new Badlar issuance increased from 24 percent in January to as high as 73 percent in April, and fell again to 33 percent in May. Also in May, the BCRA again started issuing 1-year Lebacs -- the longest maturity available for these

instruments.

BCRA's financial result reached ARP 2.6 billion in 2005.

21. The BCRA's financial result (the difference between financial income and outflows) reached ARP 2.6 billion in 2005, more than double the 2004 result of ARP 1.3 billion. The net financial result (which also includes operational expenditures and valuation differences due to exchange rate changes) stood at ARP 5.0 billion (up 45 percent y-o-y).

22. According to some private analysts, last year's strong balance obviates concerns about a BCRA quasi-fiscal deficit for 2006. Fears of a quasi-fiscal deficit arose because of the difference between the interest rate earned on reserves (BCRA assets) and the interest paid on Lebacs and Nobacs (BCRA liabilities), as well as the reduction in the BCRA's discount lending stock due to bank prepayments. (Discount lending is one of the best performing BCRA assets, as it earns 3.5 percent plus CER -- a CPI-linked index.) Analysts project an ARP 1.5 billion financial result for 2006, a significant drop from 2005 due to the drop in income from BCRA discount lending mentioned above, as well as from the expected increased interest that the BCRA will pay on Lebacs and Nobacs due to higher sterilization requirements (assuming that the BCRA maintains its current reserve accumulation policy and that discount loan prepayments will not be able to help the BCRA sterilize its FX intervention as much as it did last year.

The peso was unchanged against the USD this week, closing at 3.10 ARP/USD.

23. The peso remained flat versus the USD this week, closing at 3.10 ARP/USD. At mid-week, the peso had appreciated slightly to 3.09 ARP/USD but then lost the recovered ground. The BCRA's intervention in the

foreign exchange market this week prevented the peso from appreciating despite large dollar sales by exporters. In the first four days of the week, the BCRA purchased USD 216 million. The peso exchange rate has depreciated 1.6 percent since the beginning of the calendar year. The BCRA's reserves stood at USD 24.3 billion as of June 6, and have increased USD 5.7 billion, or 31 percent, since the GOA prepaid its entire IMF debt on January 2.

Consumer Confidence Index up 3.1 percent m-o-m.

24. The consumer confidence index -- measured by Torcuato Di Tella University -- increased 3.1 percent m-o-m in June to 58.5 points, from 56.8 points in May. All three index components increased: consumer sentiment toward the macroeconomic environment (+6.8 percent m-o-m), consumer willingness to purchase durable goods and real estate (+1.6 percent m-o-m, to a new record high) and improvement in personal situation (+0.6 percent m-o-m). The index increased 15.6 percent y-o-y. The index is based on surveys of individual economic sentiment and consumer willingness to purchase durable goods, houses and cars.

Commentary of the Week: "Lavagna, Moreno, and the Felisa Code". By Jorge Oviedo. (Note: Translated from an article published May 26 in La Nacin. End Note)

¶25. The opinions of the general public and of business leaders converge on one thing: Nestor Kirchner can point to significant economic growth, fairly reasonable inflation rates up to now, and the maintenance of a fiscal surplus as his achievements. But the opinions of those who have business responsibilities and of those who do not begin to sharply diverge when one goes deeper into other issues. For example, take the inflation control policy.

¶26. To the general public, it seems praiseworthy that the government is trying to control prices, although it doesn't believe that price controls work. Businesses, in many cases, are alarmed by the attitude of the Secretary for Technical Coordination, Guillermo Moreno. "I have known him for many years, to the point that I can say we have been quite good friends. But in my modest opinion, he has always been a little crazy," said someone who says that the stances that have been attributed to Moreno are alarming, although he clarified that they did not surprise him.

¶27. The divergence between public opinion and that of business leaders is the division that Roberto Lavagna wants to exploit. Polls among businessmen show a strong deterioration of the government's image since the departure of Lavagna, ex-Minister of Economy and founder of the consulting company Ecolatina. "The problem that Roberto has is that to be a candidate, he is going to have to convince far more than just a handful of company owners that everything has gotten worse since he left," said one businessman.

¶28. Outside of the corridors of power, the ex-minister's image is one of moderation and rationality, but that has not stopped him from being a critic of current policies. However, it is notable that he has been very careful not to criticize Kirchner.

¶29. During the last few days, the surprise has been that Minister of the Economy Felisa Miceli has again publicly aligned herself with her predecessor and one-time promoter: Miceli appeared in public with Lavagna during the most recent meeting of the Inter-American

Development Bank, at a time when tensions with Lavagna in the Casa Rosada already were high.

¶30. This week, she met with textile businessmen who had a meeting with Moreno not too long ago that, according to accounts, had been very tough. The minister didn't receive them in her office, but rather visited them at the ProTejer Foundation headquarters. She said, very reasonably, that annual 9 percent growth rates cannot be expected to continue, and that less must be anticipated: "barely" 5 percent annually. All this would be nothing more than a demonstration of rationality, if one looks at it benevolently, or as an excess of optimism, if one wants to be critical.

¶31. But everything changes when one realizes that, according to the business owners he meets with, Moreno tells his audiences that he wants to end this year being the "Nine Man." He would earn the title by achieving 9 percent growth, 9 percent inflation and 9 percent unemployment.

¶32. Very casually, Minister Miceli just said in public that 9 percent growth will be difficult to achieve. The agriculture sector is finding it difficult this year to increase growth, and the meat export ban made things even worse. Moreno will realize that the message in the "Felisa code" was intended for him. The arm-wrestling between the two officials seems far from over. (Note: We reproduce

selected articles by local experts for the benefit of our readers. The opinions expressed are those of the authors, not of the Embassy.)

GUTIERREZ